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C O N F I D E N T I A L SECTION 01 OF 05 BRASILIA 002885

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E.O. 12958: DECL: 11/22/2014

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SUBJECT: CHINA'S ONE NOTE SAMBA WITH BRAZIL

REF: (A) BRASILIA 1185 (B) BRASILIA 9600 (C) BEIJING
18406

Classified By: Economic Officer Janice Fair,
Reasons 1.4 (b) and (d)

1. (SBU) Summary and Introduction: On November 11 Brazil rolled out the red carpet for Chinese President Hu Jintao, in country for a five-day state visit. Commercial issues dominated the bilateral discussions. In its demand that Brazil recognize its "market economy" status in exchange for trade and investment concessions, China played hardball -- and won. Many in Brazil's private sector fear -- with reason -- that Brazil was out-negotiated and Brazilian manufacturers will ultimately pay the price. Although eleven official agreements and six commercial agreements were signed, many in Brazil are skeptical about the promised commercial pay-off. The Chinese avoided making explicit political concessions to Brazil over its bid for a permanent seat on the U.N. Security Council and Brazil's candidate for the WTO Director General job, Ambassador Seixas Correa, although in closed talks the PRC gave the GOB implicit support on the former issue. Brazil indicated it remained behind the "one China" policy but refused to press Paraguay, a fellow member of Mercosul, to drop its recognition of Taiwan. Human rights were not addressed and for all intents and purposes, the Sino-Brazilian Human Rights Commission is dead. End Summary.

A One-Note Samba

2. (C) Over 200 government officials and business people accompanied President Hu Jintao to Brazil November 11-15 in a follow-up to President Lula's own five-day state visit to Beijing less than six months earlier (refs a and b). While the development of a bilateral strategic partnership served as the principal theme for Lula's trip to Beijing, Hu's visit took a narrower, largely trade and commercial focus. According to Brazilian Minister of Development, Industry, and Trade Luiz Furlan, the Chinese came to Brazil "with a one-note samba." The simple song paid off. After negotiations lasting 20 hours, described by an experienced Ministry of External Relations (MRE) observer to poloffs as the most difficult he had ever witnessed, President Lula agreed to the Chinese President's sole demand -- Brazilian recognition of China as a market economy. (Note: During its WTO accession in 2001, China agreed to designation as a non-market economy. Since then, China has aggressively pursued a campaign to convince WTO members to designate it as a "market economy," a concession that would constrain implementation of safeguard actions and anti-dumping cases against its products. End note)

3. (C) According to MRE's Head of Asia and Oceania Division and former DCM in Beijing, Edsen Montero, prior to Hu's arrival, the GOB was determined stay with a policy of not granting market economy status. As a fallback position, it was decided internally the GOB would follow the EU position: not designate China a "market economy" but allow the issue to advance by treating it at a technical level. However, when face-to-face, the Chinese insisted that market economy recognition preceded any commercial concessions. After exhaustive talks, political considerations eventually trumped commercial ones when President Lula -- going against the advice from his technical staff in the Ministry of Development, Industry and Trade and MRE, both of which argued that Brazilian industry would be prejudiced -- decided to make a sweeping gesture to Brazil's "strategic partner." The Brazilians were not unaware of the risks, Montero affirmed, and made clear to the Chinese that this was not a license to dump products on the Brazilian market. On the trade side of the house, Brazilian officials were chagrined by Lula's decision, with Montero noting that Chinese shirts were for

sale for as little as two reals (\$0.70) in local markets.

Commercial Trade-Offs

14. (U) For its trouble, Brazil was rewarded with the promise of a "privileged status" and of greater market access for Brazilian products. Even though as an export destination China is still a distant second to the United States, which absorbed \$16.3 billion in Brazilian exports through October 2004, growth in trade with China figures prominently in Brazil's plan's for export expansion and diversification. Bilateral trade is up over 330% in just five years and climbing steeply; China is now Brazil's largest market for soybeans and other primary products. In 2003 Brazilian exports to China more than doubled reaching \$4.5 billion with two-way trade valued at around \$6.7 billion; already through October 2004, two-way trade for the year has reached \$7.7 billion.

15. (C) However, a more dramatic trade opening between the two countries appears unlikely in the near-term. Ronaldo Costa Filho, Head of Itamaraty's European Union and Extra-Regional Negotiations Division told econoff that despite talk of a possible FTA during Lula's trip to China in May, it was not on the agenda for President Hu's visit. Neither side was pushing to resume discussions on terms of reference for an FTA feasibility study that had lapsed since July; Costa explained that Brazilian private sector's extremely, negative reaction to a potential opening to the Asian giant had caused the GoB to back-off. During Hu's visit, the GoB wanted to pursue more specific trade interests and had hoped to advance prospects for higher-value added products. However, only agreements covering Brazilian exports of fresh beef and chicken were signed; these sanitary agreements will purportedly result in exports worth \$150 million next year and potentially \$800 million over the next three years.

16. (U) A more compelling commercial enticement for Brazil was likely China's promise to consider investing as much as \$10 billion in Brazilian infrastructure projects over the next couple years. The GoB has yet to get its public-Private Partnership (PPP) legislation through Congress and is desperate for infrastructure investment to ease bottlenecks that threaten to constrain exports. The lack of a set PPP framework has held up Chinese commitment on around \$2 billion in projects to revamp a North-South rail-line and expand the port of Itaqui in Maranhao, projects geared toward facilitating exports to China of Brazilian soybeans, iron ore and wood. The Hu visit did produce an agreement for construction of a \$1.3 billion gas pipeline running from Rio Janeiro state to Bahia.

Chinese Mum on Support for Brazilian Seat on UNSC

17. (C) Montero noted that while the Chinese government privately backed Brazil's bid for a permanent seat on the UNSC, the PRC continued its refusal to offer a public statement of support. Instead, he said, China kept to its clever "incomplete syllogism," used first during Lula's Beijing visit in May -- "the UNSC should be expanded, the developing world needs representation on the UNSC, and Brazil is a developing nation." A senior Japanese diplomat in Brasilia had opined to poloffs that political tensions between Japan and China (and to a lesser extent, tensions with India) complicated any Chinese endorsement of a seat for Brazil. Montero fully agreed with this assessment. China's endorsement of any one of the self-proclaimed candidates for a permanent UNSC seat, he believed, would run the risk of alienating non-endorsed candidates.

Comment: One wonders whether the GOB leadership adequately analyzed this paradigm from the PRC perspective before conceding on the market economy question. End comment

Backlash

18. (SBU) With the concession on market economy status, Brazil became the first Latin American country to accede to China's demand, as well as the largest anywhere to date. Montero agreed that Brazil's action could have repercussions within Mercosul and elsewhere on the continent. Given Brazil's economic size and regional dominance, the designation is perceived here as a major victory for PRC trade policy and a big gamble by the GOB. Despite his earlier remarks that China was clearly not a market economy, Minister Furlan publicly downplayed the impact of the decision on Brazilian industry and claimed Brazil, in return, had won significant concessions. But privately, the

Minister could not have been happy. Meanwhile, negative reaction from Brazil's industrial sector to the market economy decision was swift. Sao Paulo's powerful Federation of Industries (FIESP) issued an official note opposing the GOB concession to China, arguing that it leaves Brazilian industry highly vulnerable. Sao Paulo will provide more details on private sector reaction septel.

19. (U) Conceding market economy status to China will now require application of stricter rules in antidumping and safeguard cases. For instance, under rules for antidumping investigations, Chinese export prices will be compared with its domestic prices, which, FIESP pointed out, do not result from market forces. Brazil currently has 13 anti-dumping orders in place against Chinese products, with one more pending -- far more than with any other country. The cases cover a variety of products such as small appliances and equipment, chemicals, bike tires, etc. Brazil also has a safeguard action against toys from China. Formally, the market economy concession will be reviewed by CAMEX, the Brazilian Foreign Trade Board, a process that could take several weeks. Montero agreed it is unlikely that CAMEX will reject or overrule the President.

Signed Agreements

10. (U) Officials agreements:

- 1) MOU on trade and investment in which Brazil grants "market economy" status to China;
- 2) Quarantine protocol and sanitary conditions for export of beef from Brazil to China;
- 3) Quarantine protocol and sanitary conditions for export of chicken from Brazil to China;
- 4) Quarantine protocol and sanitary conditions for export of thermally treated pork from China to Brazil;
- 5) Quarantine protocol and sanitary conditions for export of thermally treated poultry from China to Brazil;
- 6) Extradition treaty;
- 7) Cooperation agreement on fighting organized crime;
- 8) MOU for cooperation in the industrial area, including on ethanol;
- 9) Complementary agreement for the construction of the China-Brazil Earth Resources Satellite (CBERS 2B);
- 10) Cooperation protocol for marketing images produced by the CBERS 2B satellite; and
- 11) MOU to facilitate tourism from China to Brazil.

Additional commercial agreements:

- 1) Cooperation agreement between China's Eximbank and China Petrochemical Corporation (SINOPEC), and BNDES and Petrobras in the \$1.3 billion Gasene project to run a gas pipeline from Rio de Janeiro to Bahia;
- 2) Agreement between Vale do Rio Doce and Yongcheng Coal and Electricity and Shanghai Baosteel;
- 3) Joint venture to produce alumina between Vale do Rio Doce and Aluminum Corporation of China;
- 4) Joint venture between ZhuZhou Rolling Stock Works and Mitsui and the Metal-Mechanic Consortium of Espirito Santo to produce rail cars;
- 5) A basic accord between Eletrobras, Companhia de Geracao Termica de Energia Electrica, Citic Group, and China Development Bank; and
- 6) Purchase of Chinese equipment by Cosipar, financed by the Import Bank of China.

Brazil Stands By "One China" Policy

11. (C) On the perennial topic of Taiwan, the GOB continued to support a one China policy and reaffirmed this position with the Chinese. during the talks, Montero pointed out, the PRC kept subtle pressure on the GOB to persuade fellow Mercosul partner Paraguay to drop its recognition of Taiwan. The Chinese effort was a non-starter, Montero said. Brazil was not prepared to lobby another country on China's behalf.

Human Rights, Dead in the Water

12. (C) On the subject of China's human rights record and the moribund Sino-Brazilian Human Rights Commission, Montero conceded that the commission was all but dead and Brazil's ability to influence China non-existent. The topic did not receive attention during President Hu's visit. The GOB did offer China expert assistance in penal and judicial reform and other areas that could help improve human rights practices, but the PRC rebuffed all efforts and even ignored proposed exchange visits. In the interest of the "strategic partnership" and, of course, Brazil's UNSC bid, Montero could not conceive of Brazil voting in favor of a China human rights resolution. Instead, Brazil will

continue its policy of abstention on any UN effort to criticize China's approach to human rights. Montero agreed it was ironic that it took a mistaken GOB human rights vote against China in 1997 to launch the bilateral commission in the first place, and he wryly smiled when asked whether a change in Brazil's future votes could actually improve GOB leverage over China.

Comment

13. (C) What swayed the GOB to concede market economy status? And did Brazil get enough concessions to justify it? On the positive side of the commercial ledger, proposed Chinese investment is concentrated in transportation infrastructure projects and easing transportation bottlenecks is crucial for Brazil to continue its export drive. The GoB expects China to keep its promises, since to further its global lobbying effort on market economy status it will not want to be seen as stabbing Brazil in the back. Nonetheless, local analysts are skeptical that the promised mega-investments will materialize and are wary of Chinese claims of market opening. The Brazilian agricultural community is still smarting over China's refusal to accept shipments of Brazilian soybeans due to alleged fungicide contamination just before President Lula's visit to that country in May. Brazil reportedly lost \$1 billion in trade due to that episode.

Agriculture Minister Roberto Rodrigues described the new agreements on beef and chicken as advances, but as with soybeans, trade in these commodities will be subject to the vagaries of China's sanitary and phytosanitary regime.

14. (C) But there was obviously more at stake in the final political analysis. China is a critical partner in President Lula's drive to "change the geography of trade" and to realign agendas within a range of international institutions to reflect developing countries' interests. The President felt that giving in to China on the market economy issue could cement the political relationship, seen as vital for obtaining these and other strategic objectives, such as a permanent seat for Brazil on the UNSC. Yet, if the GOB decision to give in to China on market economy status was seen as a quid pro quo for public Chinese support for a permanent Brazilian seat on the UNSC, the strategy did not pan out.

CHICOLA